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IN THE

Supreme Court of the United States

October Term, 1972

No. 72-523

PLANTATION PATTERNS, INCORPORATED,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

JOHN S. JEMISON, JR. and MARIE S. JEMISON,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF OF *AMICUS CURIAE* IN SUPPORT OF PETITION

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BRIEF OF *AMICUS CURIAE* IN SUPPORT OF PETITION

Reasons for Submission of *Amicus* Brief

The writer of this brief is a stranger to the taxpayers-petitioners and their attorneys.

The reason for his concern is that the basic form of the transaction by which Plantation Patterns, Inc. (New)

acquired the assets and business of Plantation Patterns, Inc. (Old) is the same that has been used at least 100,000 times by other buyers and sellers in the past 25 years and is still being used every day in the week as a perfectly proper, legal and businesslike method of financing the purchase of a going business.

The Fifth Circuit has completely misconstrued a simple, ordinary, garden-variety business deal, understood by all of the parties to be a corporate transaction, as being a somehow disguised acquisition by Mr. Jemison as an individual. The result is that the corporation is taxed with the actual income and Mr. Jemison with "imagined" income. This is double taxation of the most vicious type.

The reaction of professional people is one of shocked disbelief. They know this case will create needless havoc in the field of corporate law and finance unless a writ is granted and the decision is reversed.

ARGUMENT

I. Illustration showing it would be impossible for an individual (like Jemison) to borrow $500,000.00 to purchase the stock of a corporation (as the Fifth Circuit claims he did).

The best way to explain the real issue is to illustrate what actually happens in this type of transaction. The parallel will be obvious.

Our client has an opportunity to purchase the stock of a corporation producing a net annual income, after salaries, of $140,000.00 for the sum of $600,000.00. The most he can raise is $100,000.00 of which $80,000.00 will have been borrowed from his father on "slow" notes which will be

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subordinate to any other financing. He will have to borrow $500,000.00 from a bank or give the sellers $500,000.00 in promissory notes payable over a ten-year period at the rate of $50,000.00 a year, with interest.

We tell our client there is no way he can possibly acquire the corporation as an individual. In order to have $50,000.00 left after taxes to pay just the principal on the notes (in addition to his living expenses from the after-tax income on his $40,000.00 salary)—$90,000.00 in all—he will have to have an income of $250,000.00, as follows:

Taxable income	$250,000.00
Less: Tax on $250,000.00 (Per Table)	158,090.00*
Left for note payment and living expense	$ 91,910.00

As a matter of fact, he would need a gross income of $280,000.00 the first year to pay the $30,000.00 of interest on the notes as an additional outlay. There would be no way he could possibly get $280,000.00 out of a corporation earning only $140,000.00 before taxes.

The utter futility of any attempt to pay a $500,000.00 debt out of dollars subject to tax on an individual return has been an accepted fact of business life ever since the government started taking the lion's share of a business-man's personal income.

* See Appendix.

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II. Typical plan of acquisition (used by tens of thousands of Jemisons).

We advise him to form a new corporation to be the purchaser of the stock. Then, by merger, his new corporation will *acquire all the assets* of the subsidiary *and become the owner of the income* out of which the annual payments are to be made. The debt will now be manageable. His corporation will pay $47,300.00 in taxes (only $110,000.00 subject to tax after the interest deduction). It will have $92,700.00 left with which to pay the $80,000.00 of principal and interest due on the notes. It will also have the combined assets to use as collateral security. Only a corporation can salvage enough out of $140,000.00 of taxable income to repay a $500,000.00 loan.

The seller understands he is dealing with a new corporation as the purchaser. Sometimes the seller asks for and gets a collateral mortgage lien on the real property and security interests in the machinery, equipment, inventories, etc. acquired by the new corporation as a result of the merger. Sometimes the new corporation purchases the assets instead of the stock and they are used as collateral. More often than not, the seller demands that the notes be personally guaranteed by the stockholder of the new corporation.[1]

Year in and year out this has been an orthodox routine method of acquiring a business on credit. In a typical transaction the seller (or banker) relies first on the ability of the business to generate enough income to pay the notes, secondly on the value of the underlying assets and, lastly, on the personal assets of the guarantor.

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[1] It makes no difference if the credit is extended by a bank or by the seller. The request for the personal guarantee of the stockholder is difficult to refuse.

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III. The Fifth Circuit's version of this is unreal.

But, says the Fifth Circuit, *this was not the real substance* of the transaction. Even though the seller, in an arms-length transaction, accepted the promissory notes of the new corporation, he was really making a personal loan to your client. Your client, though only guaranteeing the notes, became the actual borrower of the $500,000.00 and contributed it to the capital of the corporation.

Therefore, any payments of principal or interest made by the corporation to the seller were in discharge of your client's personal debt and taxable to him as "constructive dividends".[2]

The amazing result of the Court of Appeals decision is to generate $250,000.00 of taxable income and $93,500.00 of taxes out of a fact situation where there was only $140,000.00 of taxable cash income to begin with. This is shown below:

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[2] Clearly in conflict with *Holsey v. Commissioner,* 258 F. 2d 865 (CCA-3) (1958) which holds that payments which discharge a corporate debt are not constructive dividends to a stockholder who benefits only indirectly. Mr. Jemison's exposure was lessened by every payment made on the corporate debt. He was not liable except in the event of a default. The benefit was indirect.

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	Taxable Income	*Tax*
Net income of corporation after salaries	$140,000	$
Less: Interest deduction	30,000	
	$110,000	
Tax at 48%, less surtax exemption on $110,000		47,300
THE FIFTH CIRCUIT ADDS:		
Additional income to corporation because of disallowance of deduction for 6% interest paid by the corporation to seller on $500,000	30,000	
Tax at 48%		14,400
Additional income to our client based on theory the principal and interest paid to the seller were constructive dividends to him	80,000	
Additional tax to him on $50,000 of imaginary income ($80,000 less $30,000 interest deduction)		31,800
Actual $140,000 of income has now become	$250,000	
Total tax on $140,000 has now become		$93,500

The decision arbitrarily and artificially reverses the substance of a genuine, arms-length transaction. The result is horrible for both our client and his corporation because:

(1) Now, the corporation is unable to repay the loan. The government is collecting $61,700.00 from it in taxes, leaving it with only $78,300.00 to service its debt.

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(2) Our client is ruined financially and for life. His only income consists of his take-home pay from his $40,000.00 salary (about $25,610.00). But the Fifth Circuit would say he must pay a $31,800.00 tax deficiency. He will spend the rest of his life in bondage. There is no way he can discharge a tax debt in bankruptcy.

This is what the Fifth Circuit decision would do to the Jemisons in the business community. The real Mr. Jemison may be able to survive it because of his other resources. But 90% of the clients who, because of their limited assets and need for credit, use a new corporation to acquire ownership of another corporation could not.

IV. Plantation Patterns contains at least six major misconceptions of both fact and law.

The basic facts in Plantation Patterns, Inc. are obscured by rhetoric and tortuous theorizing about matters that are not a bit germane to the problem. There are no fewer than six major misconceptions as follows:

(1) The "thin corporation" theory[3] does not apply to the facts of the case. It applies only when (a) a *stockholder* claims that payments made to *him* were in repayment of a genuine loan, or (b) a corporation claims that the interest it paid to a *stockholder* was a legitimate interest deduction. The Jemisons were the stockholders. Plantation Patterns, Inc. paid nothing to them and claimed no deductions for any amounts paid to them. All payments were made to *creditors*.

[3] This theory serves a useful purpose in preventing a stockholder from getting dividends out of his corporation disguised as interest or as a return of capital. It was not intended to prevent creditors from being paid their just debts.

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(2) The ratio of debt to equity is not germane to either the facts or the issues. It applies only when a stockholder supplies both. It does not apply when a stockholder supplies the loan.[4] Debt to creditors can never be equity in any sense of the word.

(3) The Court assumes that Plantation (New) had nothing but a $5,000.00 capital investment and Mr. Jemison's guarantee to support a $759,000.00 debt. It lost complete sight of the fact that, when the transaction was closed, Plantation (New) acquired, by merger, all of the assets of Plantation (Old). The surviving corporation was completely solvent and the combined assets were completely adequate to support the debt as is shown in the Court's own footnote.

(4) The fact that some notes to *creditors* are subordinate to other notes to *creditors* is a wholly improper criterion for determining that some of them are debt and some are equity. They could never be equity, no matter how subordinate, any more than a second or third mortgage loses its identity as a debt by being subordinate to the first or second mortgage.

(5) By attaching special significance to Mr. Jemison's guarantee and none to the guarantee of the $11,000,000.00 Jemison Investment Company, Inc., the Court of Appeals made strange new law. It said, in effect, that a *person* who guarantees a note becomes the real debtor, the "primary obligor" no less; but that a corporate guarantor remains only a guarantor. The Court is saying, in substance, that any stockholder who personally guarantees the loans of a corporation is taxable on his share of the income of the corporation used to repay its debts. It would be a sad day for the American economy if this were true.

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[4] The ratio of debt supplied by creditors to equity supplied by a stockholder is an arms-length transaction. There is no self dealing for the Court to be concerned with.

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(6) Perhaps the most glaring misconception was the Court's insistence that the wherewithal to pay the debt be found only on the balance sheet. The Court looked every place except the right one—the profit and loss statement.

The table set forth below shows the earnings available for the three-year period immediately following the acquisition, and the amount actually required:

Year	Net Income After Taxes	Interest Deduction On Notes and Debentures	Depreciation Deduction	Amount Available For Debt Services	Amount Required For Debt Service
1963	$73,938	$43,293	$55,763	$172,994	$93,293
1964	99,467	40,593	63,069	203,129	90,593
1965	57,574	37,756	68,937	164,267	87,756

This was the real substance of the transaction. It was only by ignoring the most important evidence in the case—the statements of profit and loss—that the Court was able to come to the inane conclusion that there was no reasonable expectation that the new corporation could succeed on its own and that no significance could be attached to the fact that it did.

V. Plantation Patterns is in fundamental conflict with the basic principles of corporate law and finance.

Plantation Patterns, Inc. has been forced into a search for conflict in the Circuit Courts to merit the attention of the Supreme Court. It has done this admirably. The Fifth Circuit's opinion is in fundamental conflict with almost every well reasoned judicial decision on the subject.[5] It is also in fundamental conflict with basic business prin-

[5] *Murphy Logging Co. v. U. S.*, 378 F. 2d 222 (CCA-9); *Arthur J. Kobacker*, 37 T. C. 882; *Kraft Foods Co. v. CIR*, 232 F. 2d 118 (CCA-2); *In re Credit Industrial Corp.*, 336 F. 2d 402 (CCA-2); *United States v. Key*, 397 U. S. 322; *U. S. v. Cumberland Public Service*, 338 U. S. 451, among many others.

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ciples as they are understood and practiced in the financial community.

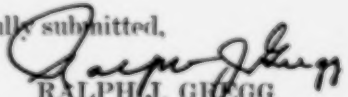
The decision has significance far beyond its effect on Mr. Jemison's pocketbook. Already many corporate lawyers are discouraging their clients from any deals where they are asked to personally guarantee corporate debts because they are concerned about the threat of confiscatory double taxation under the "constructive dividend" theory.

On the other hand, many banks and sellers insist on the traditional personal guarantee. They are not a bit concerned about the buyer's tax problems and scoff at the lawyers fears of constructive dividends. Hence, a stalemate in many thousands of business transactions that should, after all these years, be governed by a rule of law that is logical and certain.

Conclusion

A writ of certiorari should be granted.

Respectfully submitted,



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APPENDIX

Page 22
1971 Tax Rate
Schedules

If you do not use one of the Tax Tables, figure your tax on the amount

SCHEDULE X—Single Taxpayers Not Qualifying for Rates in Schedule Y or Z

If the amount on Form 1040, line 50, is:		Enter on Form 1040, line 19:	
Not over $500		14% of the amount on line 50.	
Over—	*But not over—*		*of excess over—*
$500	$1,000	$70+15%	$500
$1,000	$1,500	$145+16%	$1,000
$1,500	$2,000	$225+17%	$1,500
$2,000	$4,000	$310+19%	$2,000
$4,000	$5,000	$690+21%	$4,000
$5,000	$8,000	$1,110+24%	$6,000
$8,000	$10,000	$1,590+25%	$8,000
$10,000	$12,000	$2,090+27%	$10,000
$12,000	$14,000	$2,630+29%	$12,000
$14,000	$16,000	$3,210+31%	$14,000
$16,000	$18,000	$3,330+34%	$16,000
$18,000	$20,000	$4,510+36%	$18,000
$20,000	$22,000	$5,230+38%	$20,000
$22,000	$26,000	$5,990+40%	$22,000
$26,000	$32,000	$7,590+45%	$26,000
$32,000	$38,000	$10,290+50%	$32,000
$38,000	$44,000	$13,290+55%	$38,000
$44,000	$50,000	$16,590+60%	$44,000
$50,000	$60,000	$20,190+62%	$50,000
$60,000	$70,000	$25,390+64%	$60,000
$70,000	$80,000	$32,790+66%	$70,000
$80,000	$90,000	$39,390+68%	$80,000
$90,000	$100,000	$46,190+69%	$90,000
$100,000	. . .	$53,090+70%	$100,000
$100,000		= 53,090	
150,000	× 70%	=105,000	
250,000		158,090	

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Appendix

SCHEDULE Y—Married Taxpayers and
if you are a married person living apart from
in this package to see if you can be consi
using Schedule X or Z.

Married Taxpayers Filing Joint Returns and Certain Widows and Widowers (see page 4)

If the amount on Form 1040, line 50, is:		Enter on Form 1040, line 19:	
Not over $1,000		14% of the amount on line 50.	
Over—	*But not over—*		*of excess over—*
$1,000	$2,000	$140+15%	$1,000
$2,000	$3,000	$290+16%	$2,000
$3,000	$4,000	$450+17%	$3,000
$4,000	$8,000	$620+19%	$4,000
$8,000	$12,000	$1,380+22%	$8,000
$12,000	$16,000	$2,260+25%	$12,000
$16,000	$20,000	$3,260+28%	$16,000
$20,000	$24,000	$4,380+32%	$20,000
$24,000	$28,000	$5,660+36%	$24,000
$28,000	$32,000	$7,100+39%	$28,000
$32,000	$36,000	$8,660+42%	$32,000
$36,000	$40,000	$10,340+45%	$36,000
$40,000	$44,000	$12,140+48%	$40,000
$44,000	$52,000	$14,060+50%	$44,000
$52,000	$64,000	$18,060+53%	$52,000
$64,000	$76,000	$24,420+55%	$64,000
$76,000	$88,000	$31,020+58%	$76,000
$88,000	$100,000	$37,980+60%	$88,000
$100,000	$120,000	$45,180+62%	$100,000
$120,000	$140,000	$57,580+64%	$120,000
$140,000	$160,000	$70,380+66%	$140,000
$160,000	$180,000	$83,580+68%	$160,000
$180,000	$200,000	$97,180+69%	$180,000
$200,000	. . .	$110,980+70%	$200,000